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TAIWAN

FISCAL TRANSPARENCY

Country Report 2005

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TAIWAN



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2005	2004	2003	2002
Clarity of roles	••••	••••	•••	••
Availability of information	•••	•••	•••	•••
Budget preparation	•••	•••	•••	•••
Accountability	•••	•••	•••	•••
Score	3.25	3.25	3.00	2.75

OUTLOOK & COMMENTARY

Taiwan continues to make steady progress towards increased fiscal transparency. However, while the government is pushing an ambitious fiscal reform package, the legislative impasse has only worsened over the past year. The President's Democratic Progressive Party (DPP) is in a minority in the legislature and the opposition are effectively blocking the government's key reform initiatives. Additionally, the large number of agencies responsible for the financial sector makes it hard to revise regulations and implement them.

A number of reforms are awaiting approval, including various tax reforms that when passed should improve the efficiency and effectiveness of the tax system. Areas that would benefit from improvement include the quantification and publication of fiscal sustainability analysis and contingent liabilities, and a definition of national debt that conforms to international standards.

The government is committed to improving fiscal transparency and efficiency, but how many of the necessary reforms will be passed and implemented under the current political constraints remains to be seen.

EXECUTIVE SUMMARY

3.25 Enacted

Taiwan continues to make steady progress towards increased fiscal transparency. The government of President Chen Shui-bian is committed to fiscal reform; however commentators noted that there have been no improvements in the legislative impasse over the past year. The President's Democratic Progressive Party (DPP) is in a minority in the legislature and so lacks the power to see its reform initiatives passed.

The Financial Supervisory Commission (FSC), established on 1 July 2004, which in 2004 commentators judged to be a large step toward improved transparency and oversight, has had mixed results over the past year. Commentators asserted that while the FSC pays lip service to banking supervision, and while it has made a start in the right direction, it has a long way to go and much still to learn. There have been a number of criticisms of the FSC including the perception that it tends towards over-regulation and micromanagement. Over the past year, the FSC has become embroiled in a large insider-trading corruption scandal, which is currently under investigation. The scandal has damaged the reputation of the FSC and that of the government. On a more positive note, commentators judged that the FSC has contributed to improved banking supervision in Taiwan, as now several disparate groups have been centralised within this one agency. The FSC has improved supervision of the financial system.

While the government is generally in favour of privatisation, it does own large parts of the financial sector, and where it has only minority interests, it nevertheless exercises considerable influence. The government intends to sell off five majority-state-owned banks before the end of 2006 including the Bank of Taiwan and the Central Trust. Taiwan Cooperative Bank was privatised in April 2005.

The government has effectively implemented the IMF Special Data Dissemination Standard (SDDS). Advance release calendars are published and fiscal data largely meet international standards in terms of coverage, periodicity, and timeliness. The Directorate-General of Budget, Accounting and Statistics (DGBAS) is using both modified accrual-based accounting and modified cash-based accounting; the intention is to move to accrual-based accounting in 2007. Commentators noted that the definition of the national debt does not adhere to international standards, and that if it did, the national debt figures would be considerably higher than those stated currently, particularly if contingent liabilities were to be included. In 2005 only one contingent liability appears in the budget, demonstrating the restrictive definition used.

There is a lack of information on fiscal sustainability in the budget documentation, and the sustainability of Taiwan's fiscal position has become a source of concern in recent years. As of July 2005, non performing loans (NPLs) are now defined as unpaid loans exceeding three months, rather than six months. The government is working hard to reduce NPL ratios and is committed to balancing the budget by 2011, though commentators judged this to be somewhat ambitious. However, the retirement age has been raised to 60 years, which should reduce pressure on the pension system, and fiscal reforms intended to create a more restrictive pension programme are underway. The shrinking tax base poses a potential problem. At the end of May 2005, President Chen Shui-bian announced plans to reduce the growing budget deficit with a programme of tax reforms intended to make the tax system fairer, to expand the tax base, to reduce tax exemptions and so on. However, they have been poorly received and are not considered rigorous enough for a fiscal system that is badly in need of an overhaul. Currently, there are three tax-reform drafts submitted to the Legislative Yuan for approval.

Taiwan's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Compliance in progress

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions, and responsibilities of government

The Constitution of the Republic of China, adopted in 1946 and amended in 1999, sets out the structure and functions of government.¹ The government is divided into five branches (yuans): the Executive, Legislative, Judicial, Control, and Examination Yuans. The Executive Yuan (cabinet) has a total of 34 subordinate organizations, including eight ministries, the Mongolian and Tibetan Affairs Commission, the Overseas Chinese Affairs Commission, the Directorate-General of Budget, Accounting and Statistics, the Government Information Office, and other special commissions and ad hoc committees. A complete list exists in English on its website.² The Constitution was amended in June 2005 and the National Assembly was phased out, leaving the Legislative Yuan as the country's unicameral legislature after the 2007 elections. As a result, the number of legislators will be cut by half at the next election.³

Taiwan consists of 18 counties (*hsien*), five municipalities (*shih*), and two special municipalities (*chuah-shih*) – Taipei and Kaohsiung. The government is correspondingly divided into central and local levels with the powers of both tiers clearly defined in the constitution. The central government has the power to “legislate and execute” in matters of national significance, including central government finance and national taxes, state-operated enterprises, state banks, and the currency system.⁴ General policy and management roles within the government sector are set out in the Organic Law of the Executive Yuan, which was adopted in 1948 and revised with subsequent changes in the government structure.⁵

Coordination and management of budgetary activities

The management of budgetary and extra-budgetary activities is entrusted to the Directorate-General of Budget, Accounting and Statistics (DGBAS), a government agency subordinated directly to the Executive Yuan. The DGBAS is responsible for budgeting, budget implementation and control, planning and appropriations, managing the reserve fund, supplementary budget appropriations, evaluation, government accounting, compilation of government balance sheets, statistical reporting, and the computerisation of the budget process.⁶

While the DGBAS is responsible for expenditures, the National Treasury, a department of the Ministry of Finance (MoF), oversees the revenue side of the budget.⁷ The major functions of the MoF include the implementation of fiscal, tax, and customs policies, and the supervision of national properties. These functions are institutionally separate, performed by distinct sub-divisions of the MoF, namely the Departments of National Treasury, Taxation, Customs Administration, and National Properties.⁸ Banks meeting certain qualifications can act as substitute treasuries for municipal and country (or city) governments.⁹

The spending ministries are granted a certain amount of autonomy due to the so-called foundational budgets of individual departments, which are not earmarked for particular purposes. In addition, the government at times introduces “special budgets” which require formal authorisation by the Legislative Yuan. In some instances,

spending commitments are carried out by non-profit special funds, including the Agricultural Stabilisation Fund, the Highway Fund, the Stock Market Stabilisation Fund, and the Nuclear Waste Disposal Fund.¹⁰ Information on these funds is scarcer than on budgetary activities, although the government is working to improve it. One commentator deemed 'special funds' and *ad hoc* entities, although not a traditional budgeting tool by western standards, to be well within the scope of the budget, and transparent. Furthermore, each fund, entity or SOE has accompanying budget books that detail their budgets and must be approved by the Legislative Yuan.¹¹

Starting in 2001, all transfers to local governments were reconfigured as ordinary subsidies. Each sub-local government unit is allocated a quota determined by financial capability, population, and land area. Under the new system, individual sub-local governments are granted the freedom to use the funds according to their needs. A special regulatory framework exists to govern the implementation of the system.¹² Local governments can contract loans and issue bonds. However, borrowing cannot exceed 15% of the total expenditure in any given year and the accumulated debt has to remain below 45% of annual outlays.¹³

Part of the official budget is a 1% 'reserve fund' earmarked for disasters. However, even though this sizeable fund is considered discretionary, its allocation must abide by legislative regulations.¹⁴

In spite of considerable improvement, the division of roles and responsibilities between different levels of government, as well as between different agencies involved in the budgetary process, remains opaque at times due to overlap and infighting. Double counting does exist between local and federal governments; however, this is due to accounting in the federal budget for subsidies to local governments, and accounting at the local level for spending these subsidies and thus can be easily identified.¹⁵

One commentator felt that the size of the actual budget, including all of the special funds, could be as much as double the current estimate released by the budget office.¹⁶

Relations between government and public sector agencies

The Executive Yuan comprises all government agencies that discharge fiscal and monetary policy functions, namely the DGBAS, the MoF, and the Central Bank of China (CBC). Certain policy areas are shared between different agencies.

The Financial Supervisory Commission (FSC) is in charge of financial supervision. The FSC, established on 1 July 2004 and chaired by Kong Jaw-sheng, is responsible for general financial oversight, with the CBC still authorised to monitor matters related to monetary and foreign exchange affairs. Taiwan's financial, securities, futures, insurance and general financial sectors are all now supervised, managed and monitored by the FSC, a single agency. Previously, authority over financial management, supervision, inspection and punishment has always belonged to different government agencies -- such as the MoF, the CBC and the Central Deposit Insurance Corporation. The agency integrates the MoF's Bureau of Monetary Affairs, Department of Insurance and Securities and Futures Commission, the central bank's Department of Financial Inspection and the Central Deposit Insurance Corporation's inspection division.¹⁷ In 2004, all commentators felt the FSC represented a large step toward transparency and oversight as it removed many of the conflicts of interest that existed when the regulatory bodies were under the umbrella of the MoF.¹⁸

However, the FSC has had mixed results over the past year. Commentators asserted that while the FSC pays lip service to banking supervision, and while it has made a start in the right direction, it has a long way to go and much still to learn. There have been a number of criticisms of the FSC including the perception that it tends towards over-regulation and micromanagement, and also that FSC commissioners, while well qualified, tend to lack bureaucratic discipline. On a more positive note, commentators judged that the FSC has contributed to improved banking

supervision in Taiwan, now that several disparate groups have been centralised within this one agency. The FSC has improved supervision of the financial system.

Over the past year the FSC has become embroiled in a large insider-trading corruption scandal, which is currently under investigation. The scandal has damaged the reputation of the FSC and that of the government. Lee Chin-chen, the former director general of the commission's examination bureau, has been indicted on charges of insider-trading. Kong Jaw-sheng, the FSC chairman, conducted an in-house investigation and exonerated Lee Chin-chen, so with the indictment this investigation looks to many like a cover-up. There are reports that mid-level employees at the Taiwan Stock Exchange could also be involved. President Chen Shui-bian's administration is trying to hasten proceedings along, as they are anxious to demonstrate that they are active in fighting corruption, but there is growing mistrust of the government. Some commentators have raised doubts as to whether any of Chen Shui-bian's financial reforms can be implemented, as he has lost much credibility as a result of this scandal and its presentation in the media.¹⁹

Taiwan has 24 state-operated enterprises and 98 non-profit public sector institutions whose budgets are included in the central government budget.²⁰ Last year, they contributed over 20% of government revenues.²¹

Government involvement in the private sector

The government is still involved in dealing with the non-performing loans crisis. The Resolution Trust Company (RTC) deals with bad loans in local financial institutions, but its work has been hampered, although not stopped, by a lack of funds.²²

The Legislative Yuan in June voted to allow the RTC's Financial Restructuring Fund (FRF), originally scheduled to shut down in July, to continue operating until July 2005. The fund was established in July 2001 to bail out debt-ridden banks regardless of whether they possessed deposit insurance. The life of the RTC has now been extended until 2011²³, after enabling legislation to boost its funds had been blocked in the Legislative Yuan for nearly three years.²⁴ Over the past year the legislature cut the funding of the RTC, providing only 10% of the amount requested by the FSC.²⁵

The FSC is considering a proposal aimed at gradually expanding the Central Deposit Insurance Corporation fund, which presently operates with just ten billion New Taiwan (NT) dollars, to 200 billion NT dollars over a ten-year period. A fund of this size would be equivalent to 2% of total insured deposits in Taiwan.²⁶ In July 2005, Taiwan's deposit insurance policy returned to limited coverage from the unlimited coverage offered previously.²⁷ Furthermore, despite a lack of funds, the RTC continues to lobby the legislature and efforts to resolve problem institutions. For example, the RTC has suspended the issuance of permits for new banking branches in order to make problem banks more attractive to foreign financial institutions looking to gain some exposure to Taiwan, thus creating banking stability by augmenting the foreign ownership in Taiwan's banking sector.²⁸

Taiwan still suffers from a problem of overlapping regulatory responsibilities in a number of areas. This frequently results in pre-emptive actions, inconsistency, and inefficiency. In some instances, decisions taken by a central regulator are contradicted by decisions and interpretations of local government agencies.²⁹

The government of Chen Shui-bian has been encouraging private and local involvement in public infrastructure projects through partnership and matching funds. The majority of these arrangements have been made under the revised Law for Promotion of Private Participation in Infrastructure Projects.³⁰

While the government is generally in favour of reducing its presence in the economy through privatisation, it does own large parts of the financial sector, and where it has only minority interests, it nevertheless exercises considerable influence. The first stage of privatisation is the responsibility of the FSC, the second stage is the responsibility of the

MoF. The eleven majority-state-owned banks include the Bank of Taiwan and the Land Bank of China. The government intends to sell off five of these before the end of 2006.³¹ The government also plans to privatise the Taiwan Tobacco and Liquor Corp. -- the nation's largest alcohol-beverage producer -- by the end of 2006 (it failed to meet earlier privatisation targets for the corporation).³² It hopes to have privatised the Bank of Taiwan and the Central Trust Bank by the end of next year. Government plans to privatise the remaining state-owned banks are still being deliberated in the Executive Yuan, so have not yet been submitted to the Legislative Yuan.³³ Taiwan Cooperative Bank announced in April 2005 its official transformation into a private bank after the government's stock holding dropped to below 50%, the threshold for a bank to qualify as privatised.³⁴ Kaoshiung Bank was sold under the RTC programme in December 2004.³⁵ The government has also shown itself willing over the past few years to intervene in the affairs of partially privatised companies, for example China Steel, in which it holds a 23% stake.³⁶

The National Property Bureau (NPB) is pursuing a strategy of surveying and registering government property, especially land. The ultimate objective is to improve the efficiency of administration and the revenue-generating potential of national assets. In addition to outright sale, greater amounts of land not used by public entities are to be leased or sold.³⁷ The NPB is required each year to compile a ledger of national property and to submit it to the Executive Yuan.³⁸

There should be a clear legal and administrative framework for fiscal management.

Legal framework for budgetary activities

The budgetary activities of the central and local governments are regulated by the Budget Law of 1998 which stipulates a five-stage budgetary process. First, the Executive Yuan draws up annual programmes and plans the budget; second, government departments prepare operational plans for the fiscal year; third, budget expenditure estimates and appropriations are approved; fourth, the DGBAS prepares the general budget proposal; finally, the Legislative Yuan adopts the proposal, and the president promulgates it. The implementation of the budget is carried out in accordance with the budget law, accounting law, a provisional statute on budget execution, and budget execution guidelines published by the DGBAS. The budgetary procedures for central and local governments were reformed in 2001-2002.³⁹

Legal framework for taxation

The Law Governing the Allocation of Government Revenues and Expenditures divides taxes, duties, and fees into national and sub-national (metropolitan, country, and city) ones. National revenues include income tax, estate tax, customs duties, business and commodity tax, and securities transactions tax. Metropolitan taxes include the land, house, vehicle, and deed taxes. A previously shared category of monopoly revenues has been eliminated following Taiwan's WTO entry.⁴⁰ There are five National Tax Administration departments, Taipei, Kaohsiung, North, Central and South, organised as administrative bureaux under the MoF. The website of the MoF provides tax laws, regulations, and reports in English and Chinese.

Some analysts have expressed concern over the lack of equal treatment of taxpayers. Larger firms often appear to pay less tax than smaller ones. The informal sector is large, and some commentators have noted that VAT is routinely avoided, though others disagreed, arguing that even small marketplace stands give you a receipt. VAT is the second largest source of revenue.⁴¹ The tax system is very favourable to the business community and the wealthy. For example, there are no capital gains taxes for stock market speculation, and the wealthy take advantage of property or business transfer schemes in order to avoid the inheritance tax.⁴²

At the end of May 2005, President Chen Shui-bian announced plans to reduce the growing budget deficit with a programme of tax reforms intended to make the tax system fairer, to expand the tax base, to reduce tax exemptions and so on.⁴³ However, they have been poorly received and are not considered rigorous enough for a fiscal system that is badly in need of an overhaul. The government's new tax initiatives are directed primarily at increasing the average national tax rate from its current 13.6% of GDP to 15% over the next three years, and to 18% by 2015-2020. The effectiveness of the tax reforms will also depend in part on the government's ability to close loopholes that have allowed individuals and corporations to avoid taxes, most obviously by placing wealth or earning revenues overseas. Minister of Finance Lin Chuan says he would like to see the plans approved before the end of the year. However, on precedent, the reforms are likely to face a difficult passage through the legislature, where an opposition majority routinely obstructs government policy.⁴⁴

Currently, there are three tax reform drafts submitted to the Legislative Yuan for approval. The first deals with the income tax and is looking to abolish the existing exemption for teachers and military service personnel.⁴⁵ The second is to establish an Alternative Minimum Tax System for individuals and corporations. Institutional investors' capital gains would be excluded from the AMT system.⁴⁶ The third measure before the Legislative Yuan looks to lower the capital gains tax on land from 60% to 40%. Another measure being considered relates to the promotion of the effectiveness of tax expenditures and the MoF is reviewing the related regulations of The Statute for Upgrading Industries, which includes special tax exemptions granted to emerging, important or strategic industries, with regard to the scope and scale of exemptions.⁴⁷

The government is also looking to raise the VAT from 5% to 7% (tax increases do not have to be submitted to the Legislative Yuan if they are within 5-10%).⁴⁸ The MoF has also drafted a medium-term measure, which includes the abolition of the Stamp Tax and the cancellation of some items of the Commodity and Amusement Tax, however this draft has not yet been submitted to the Legislative Yuan. The land value increment tax rate has been reduced to 40%, 30% and 20%, effective from 1 February 2005.⁴⁹

The government has in the past repeatedly adjusted tariff rates on daily necessities and industrial raw materials for the purposes of price stabilisation and accelerating industrial development.⁵⁰ However, tariff reduction is necessary to meet Taiwan's WTO commitment, and the target average effective rate is now set at a level comparable to industrialised countries.⁵¹

The DGBAS has adopted mechanisms in order to prevent tax losses, and the MoF guidelines for the Finance Administration envisage a reform of the still elaborate tax system to promote economic development, as well as to enhance the efficiency of collection and to improve services to taxpayers.⁵²

Ethical standards for public servants

The rights and obligations of civil servants and the standards to which they are accountable are laid out in the Civil Servants Act and the Code of Conduct of Civil Servants.

Corruption, although substantially diminished, remains in Taiwan and is perpetuated by a deeply entrenched culture of complacency and a tradition of kickbacks.⁵³

While the extent of corruption among public servants is notoriously difficult to measure, candidates in national elections often personally spend 5-10 times their projected salary on their campaigns, indicating that public office entails a range of unofficial benefits.⁵⁴ Commentators also pointed to numerous dubious political donations and extensive Kuomintang-owned assets as ongoing proof of political corruption.⁵⁵ Given the local cultural tradition, there is often a thin line between political lobbying and outright corruption. On the other hand, foreign companies operating in the country have in many cases been able to remain completely unaffected by corruption.⁵⁶

The FSC seems to be taking measures to address corruption, at least anecdotally. For example, in September 2004 it launched a toll-free phone line to encourage consumers to report inappropriate measures and malpractice on the part of financial institutions with the hope of combating corruption and encouraging financial institutions to improve their services to the public.⁵⁷

The democratisation of Taiwan has added a new dimension of legislative interference. This results in inconsistent actions and even sudden reversals of decisions. The partisanship within the Legislative Yuan has been repeatedly blamed for the lack of progress in fiscal and monetary reform.⁵⁸ The lack of standard operating procedures for dealing with large projects is also a problem.⁵⁹

2. PUBLIC AVAILABILITY OF INFORMATION



Enacted

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Central government operations

The MoF began publishing online economic and financial data according to the IMF's Special Data Dissemination Standard (SDDS) in late 2002. Taiwan is not a member of the IMF and cannot therefore publish its data on the Dissemination Standards Bulletin Board. However, it largely complies with the SDDS requirements for coverage, timeliness, and periodicity.

Monthly data published on the MoF website cover general government operations, central government operations, and central government debt.⁶⁰ Data on central government operations cover revenue and grants, expenditure and net lending, the balance, and financing broken down into net borrowing and use of cash balances, further broken down into use of foreign exchange cash balances.⁶¹ The MoF also publishes its comprehensive *Monthly Statistics of Finance* online, which covers major financial and economic indicators; revenues and expenditures of the National Treasury; and net tax revenues by item, district, and commodity. These data are summarised in the *Yearbook of Tax Statistics* and *Yearbook of Finance*, both of which are available on the website of the MoF for the previous fiscal year in Chinese.⁶²

The actual budget is published online and is available in Chinese and English. It follows a basic three-year framework with the definitive outcome for the preceding year and the estimates for the current and coming fiscal years.⁶³ Also, three years of historical data are published online.

Expenditures are broken down into current and capital account appropriations. The process of assessment and justification of capital account spending is done before public investment projects are included in the budget book by the Council on Economic Planning and Development (CEPD).⁶⁴ According to the Budget Act, governments may not exceed their budgetary allocations unless permitted by other laws. Any borrowing outside of the government budget with a maturity of more than one year is counted as public debt.⁶⁵

All central government operations are accounted for in the budget documents with the exception of the classified budgets of the Ministry of Defence, the Ministry of Foreign Affairs, and the National Security Board. While there has been a visible reduction in the classified portion of the budget over the past few years, security considerations are unlikely to permit complete transparency in these areas.

Public sector operations

Data on general government and public sector operations are also published on the website of the MoF. General government operations include the central and local governments, and consolidated data are disseminated on revenue, expenditure and balance. The DGBAS is using both modified accrual-based accounting and modified cash-based accounting. The intention is to move to accrual-based accounting in 2007.⁶⁶ Consolidated data on central and general government operations provide an indication of the fiscal position of the government and public sectors respectively.⁶⁷

A commitment should be made to the timely publication of fiscal information.

Debt reporting

Monthly statistics on central government debt are disseminated on the website of the MoF. The data are broken down into domestic and foreign debt. Data on total debt are classified according to instrument, residency, maturity, and debt guaranteed by the central government.⁶⁸

Commentators noted that the definition of the national debt does not adhere to international standards, and that if it did the national debt figures would be considerably higher than those stated currently, particularly if contingent liabilities, such as pensions and healthcare, were to be included. They further noted that non-profit government funds are in debt, and these are also not included in government debt figures.⁶⁹

Advance release calendars

An advance release calendar, which gives at least one month's notice of the precise release dates for central government operations, debt and general government operations, is disseminated on the MoF website.⁷⁰

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING



Enacted

Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

Fiscal objectives are set by the DGBAS and the Council on Economic Planning and Development (CEPD), and are stated clearly in the budget documentation. This information is available on the DGBAS website.⁷¹ The introduction of new policies is announced in the budget.

More extensive ministry-level information is provided by the individual line ministries and made available on the web, although not always in English.

Macroeconomic framework

Economic forecasts are prepared by the DGBAS and included in the budget package. The CEPD is responsible for setting out the economic goals for the year.

The quantitative macroeconomic framework within which the budget is prepared is based on a Keynesian model adapted to take into account the nature of Taiwan's economy. The main parameters used by the model are government expenditure and revenue, consumption, currency markets, labour markets, and price information. Independent experts are often hired to review the model, provide advice, and allow the predictions to be adjusted in light of changes in the economy. All information regarding models, predictions, and assumptions is available on the DGBAS website.⁷²

The DGBAS is responsible for forecasting budget-related trends such as expenditure and revenue growth, as well as economic growth and other key macroeconomic variables. The National Treasury Office of the MoF projects trends in tax revenues. During budget preparation, the DGBAS collates all relevant materials from different government agencies so as to produce a unified budget estimate.

The task of assessing fiscal forecasts, and the macroeconomic assumptions on which these are based, is entrusted to a committee of 25 people, led by the head of the DGBAS. This committee consists of experts from different organisations, such as the Central Bank of China, the Ministry of Finance, the Ministry of Economic Affairs, and Academia Sinica (Taiwan's principal university). Independent experts are also invited to join the committee, which meets regularly to discuss budgetary matters, economic trends, and relevant economic issues. DGBAS officials emphasised that these independent scholars play an important role in reviewing budgetary, accounting, and statistical data in committee meetings.⁷³

Fiscal risks

No comprehensive assessment of fiscal risks is included in the budget documentation, although some risks, such as pension obligations, are covered. There is also a summary within the budget explaining how fiscal risk in general is being addressed. While contingent liabilities are disclosed to some extent in the budget, the breadth and scope of this disclosure is debatable. In 2005, again, only one contingent liability appears in the budget (Taiwan High Speed Rail

Company) demonstrating the restrictive definition used. According to the Budget Act (Article 9) and the Final Report Act (Article 4), when compiling annual budgets and final reports, a public agency has to review its ability to provide guarantees and must prepare tables to demonstrate future expenditures created by such guarantees.⁷⁴

The main risks at the moment are posed by contingent liabilities and NPLs stemming from government departments, medical insurance, and the pension debt. The government has made substantial efforts, and has actually been quite successful, in resolving the NPL problem, and the Debt Management Fund is trying to resolve the contingent liabilities.⁷⁵ Since the medical insurance and pension systems were created as self-financing entities, their borrowing is not included in public debt.⁷⁶ The retirement age has been raised to 60 years, which should reduce the pressure on the pension system for a period of time, and fiscal reforms are intended to create a more restrictive pension programme.⁷⁷ The government intends to cap pension incomes to between 80-90% of income on retirement.⁷⁸

NPLs are defined according to international classification standards. As of July 2005, NPLs are now defined as unpaid loans exceeding three months, rather than six months.⁷⁹ The government is working hard to reduce NPL ratios. As of 2003, the relevant statistics comply with international best practice.⁸⁰ In 2003, the problems of First Financial Holding Company, the Chung Shing Commercial Bank, the Bank of Overseas Chinese, and the Kuo Hwa Life Insurance Company prompted the government to consider a financial sector reform and have since been resolved or are pending resolution.⁸¹

One area where progress could be made with risk assessment is exogenous shocks. These typically involve earthquakes or the impact of energy price shocks due to the island's heavy dependency on imported fuel. SARS and avian flu have been among other recent risks. Similarly, changes in relations with the People's Republic tend to have economic repercussions.⁸²

A new law that authorises tax collection at the local level has resolved problems related to the lack of resources for local governments, and will improve the fiscal situation at the local level.⁸³

Fiscal sustainability

No information is provided on fiscal sustainability in the budget documentation. The sustainability of Taiwan's fiscal position has become a source of concern in recent years, following a dramatic increase in the public debt-to-GNP ratio from 5% in 1990 to 34.6% at the end of 2004. The estimated accumulated public debt for the end of 2005 will reach 3,680 billion NT dollars, which accounts for 35.9% of the average GDP of the preceding three years. It does not exceed the 40% limit set by the Public Debt Act. The estimated public debt at the end of 2006 is 3,900 billion NT dollars, or 37.3% of the average GDP of the preceding four years, increasing by 1.4% compared to that of 2005. This increase margin would be the lowest in four years.⁸⁴ Some estimates suggest that this figure would be much higher if contingent liabilities related to health care and pension funds were included.⁸⁵ However, some commentators felt that the health care and pension funds should not be considered contingent liabilities as they are self financing. Furthermore, the health service recently raised premiums and the pension fund recently increased employee's contributions in order to avoid indebtedness. Both indicated that this strategy would be used again in the future to avoid going into debt.⁸⁶

While the official figures are not alarming in international comparison, the growing debt-to-GNP ratio, coupled with Taiwan's continuing, though much diminished, NPL problem, puts a strain on the ability of the government to use fiscal policy as a counter-cyclical measure or to embark on the structural reforms of the pension and health care systems, which would be necessary to restore the fiscal situation to full health. Nonetheless, the markets seem able to absorb the government debt, and even if the recent relatively rapid increase were to continue further, it does not appear that it would put pressure on interest rates in the near term.⁸⁷

The shrinking tax base poses a potential problem. Taxes accounted for 13.6% of GDP in 2004.⁸⁸ In order to prevent a further deterioration of Taiwan's fiscal position, the Executive Yuan set up the Fiscal Reform Committee in September 2001 consisting of enterprises, scholars and various ministers. After meeting over the course of a year and half, the committee submitted 48 proposals. The MoF then set up the Fiscal Reform Plan based on these recommendations. In April 2003, the Executive Yuan approved the plan consisting of 60 fiscal reform measures, divided into short, medium and long-term measures.⁸⁹ Currently the MoF is proceeding with short-term tax reform measures and will endeavour to implement the remaining reforms in the near future.⁹⁰ The government asserts that if all the reforms can be completed as planned, then the budget will be balanced by 2011. Last year real tax revenue exceeded forecasts by \$15 million NT dollars (\$500 million US dollars). It is the first time taxes have exceeded forecasts since 1999. This year the government aims to increase tax revenues, and the budget proposal for 2006 foresees an increase in revenues of 5.3%. However, commentators judged that the goal of balancing the budget by 2011 is rather ambitious.⁹¹

Budget presentation

Data reporting

Having implemented the requirements of the SDDS, Taiwan largely complies with international standards on the presentation of budgetary data. Budget data for the central government and public sector are reported on a net basis, distinguishing revenue, expenditure, and balance for both sectors, as well as financing for the central government. The expenditures of the central government are broken down into current and capital account spending, specified according to administrative branch. The methodology of data reporting, such as definitions and classifications, are disseminated by the DGBAS in the Central Government Agency Budget Implementation Guidelines.

Taiwan has a fairly elaborate system of tax expenditures, although most of them have been gradually declining over time. The Executive Yuan issued proposals for a Tax Expenditure Policy Evaluation Mechanism that have been incorporated in the Fiscal Reform Plan. The Guidelines for Tax Expenditure Policy Evaluation Operations were approved by the Executive Yuan in July 2003.⁹²

Budget execution and monitoring

Monitoring the execution of the budget is a responsibility of the DGBAS. Procedures for the execution of approved government expenditure are specified in the Central Government Budget Execution Provisional Statute and the Budget Execution Guidelines for Central Government Agencies and Subordinate Agencies. These cover a stage-by-stage budget execution plan, restricting the transfer of funds for undesignated purposes, the establishment of a reserve fund, the evaluation of budget execution performance and the guidelines for all collected revenues.⁹³

Accounting basis

The DGBAS is using both modified accrual-based accounting and modified cash-based accounting. The intention is to move to accrual-based accounting in 2007.⁹⁴

Government accounting has a clear legal basis in Taiwan. Receipts and payments are channelled through the cashier process of the National Treasury according to a budget allocation plan. Information on payments and receipts are regularly compiled to show the status of the execution of the budget, which is then submitted to the relevant agencies for reference. At the end of the year, DGBAS prepares a general accounting report with detailed information on revenue, expenditures, balance, and changes.⁹⁵ The year-end report analyses the performance of the previous, and current, year's plan. The report also has detailed non-financial information about the budget.

Procurement and employment

Employment regulations are set out in the Labour Standards Law and Employment Services Act. The government has made efforts in recent years to standardise employment regulations by bringing a large number of service industries previously exempt from these provisions under the remit of the Labour Standards Law. The Council of Labour Affairs is responsible for matters pertaining to employment regulations and adjudication of disputes.

Procurement regulations are set out in the Government Procurement Law, which was passed in 1998 following a spate of corruption scandals. This law seeks to guarantee the fairness and efficiency of government procurement and has stringent penal provisions on bids that break the rules of competition. Since joining the WTO in 2002, Taiwan has embraced the Government Procurement Agreement. Partly as a result, access to information about government projects has increased markedly, even as problems with excluding foreign firms and lack of transparency remain to be fully addressed.⁹⁶

While the new administration of Chen Shui-bian has done a great deal to disentangle the intricate ties that link the Kuomintang-led political elite to economic interests in Taiwan, the country still faces a long-term battle to eliminate corruption. Taiwan is ranked 32nd in Transparency International's 2005 Corruption Perception Index of 159 countries with a score of 5.9 out of a perfect 10.⁹⁷

The government tendering process continues in many cases to be rigged by "special standards" that deviate from international best practice and force companies to take on various contingent liabilities. This process frequently shuts out foreign companies, while Taiwanese companies in some cases manage to avoid their legal obligations by declaring bankruptcy at the end of the project.⁹⁸

Fiscal reporting

The DGBAS compiles central government semi-annual and annual financial reports. These reports are submitted to the National Audit Office for cross-examination, and the reports are submitted to the Legislative Yuan for approval. At the end of the fiscal year, DGBAS also prepares a budget settlement report to show the achievements of the budget and trends in public finance and macro-economic development, and to create a performance benchmark for next year's budget.⁹⁹ The statistical information available on the budget is generally deemed to be consistent, thorough, and reliable, although there have been some disputes with independent analysts on definitions.¹⁰⁰

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY



Enacted

Data quality standards

The clearest guarantee of the quality of fiscal data supplied by Taiwan is the country's compliance with SDDS for coverage, periodicity, and timeliness.¹⁰¹ The budget data reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments. This also applies to data supplied in the *Yearbook of Finance* and *Yearbook of Tax Statistics*, Taiwan's two key fiscal publications. Most fiscal data is published in both English and Chinese.

Independent scrutiny of fiscal information

Independent Audit

The 1998 Law of Audit governs fiscal audit in Taiwan.¹⁰² Taiwan has a tripartite system of auditors that operate under the auspices of the Control Yuan. The National Audit Office is in charge of auditing central government finances and those of related institutions. There are four audit divisions responsible for auditing municipal governments. 15 county and city-level offices are responsible for local audits. Public enterprises with a majority government stake are also subject to audit.¹⁰³ The main types of audit at the moment are document, on-site, random, and entrusted audits. The Law on Audit specifies measures available to ensure compliance with auditors' recommendations, including disciplinary action by the Control Yuan.¹⁰⁴ Commentators noted that the Control Yuan has experienced problems over the past year in that it has no members; the opposition has rejected all appointments proposed by the government. Yet its auditing function is still working.¹⁰⁵

The main official responsible for government audit in Taiwan is the Auditor General who is appointed by the president and approved by the Legislative Yuan for a six-year period. His independence is constitutionally enshrined.¹⁰⁶ The Constitution requires the Auditor General to complete the audit of the central government's financial statements within three months of their submission by the Executive Yuan.¹⁰⁷ The results of the audits for the central government, regional governments, government enterprises, special funds, and other entities are published on the Ministry of Audit website.¹⁰⁸

National Statistics Agency

Statistical functions are performed by the DGBAS, whose independence from other government departments is ensured by its direct subordination to the Executive Yuan. This does not, however, ensure its independence from the cabinet. While fiscal information is generally held to be reliable in Taiwan, other data, such as capital flows between the mainland and Taiwan, continue to be substantially improved by the Taiwanese authorities. Commentators claimed that the sensitive nature of Taiwan's bilateral ties with the mainland did not have any serious repercussions for budgetary data.¹⁰⁹ The National Budget, Accounting, and Statistics Network (eBAS) has created a nationwide system for handling statistical work.¹¹⁰

The improved quality and scope of statistical data have led to their increasing use in economic modelling and forecasting by the DGBAS. Further reform efforts in this area are ongoing. The DGBAS publishes a *Monthly Bulletin of Statistics* and a *Statistical Yearbook*.¹¹¹

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals in Taiwan between 24 and 27 October 2005:

Ministry of Finance (MoF)

27 October 2005

Shelly Chen	Director, National Treasury Agency	Ministry of Finance
Bichen Tsai	Section Chief, Department of Taxation	Ministry of Finance

Directorate-General of Budget, Accounting and Statistics (DGBAS)

25 October 2005

Judy Chen	Researcher	First Bureau (budgeting for official agencies)
Lin ShunYi	Senior Executive Officer	First Bureau
Huang Y.S.	Senior Researcher	First Bureau
Huang Su Ghen	Senior Executive Officer	Second Bureau (budgeting for state-owned enterprises and non-profit funds)
Liou Ruey Wan	Senior Executive Officer	Third Bureau (national statistical affairs)
Huang Yong Chuan	Director of Accounting	Accounting Operation Task Force
Huang Cheng Chang	Senior Executive Officer	Accounting Operation Task Force

Central Bank of China, Taipei

25 October 2005

We met two senior central bank officials who requested anonymity.

ADDITIONAL INTERVIEWS

Monday 24 October

Chi Schive	President	Taiwan Academy of Banking and Finance
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26 October 2005

Timothy Neely	Deputy Chief, Economic Section	American Institute in Taiwan
Wang Yung Shan	Economics Specialist	American Institute in Taiwan

27 October 2005

Miao Chen	Associate Research Fellow	Taiwan Institute of Economic Research
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Oxford Analytica representatives met with another private sector representative who requested anonymity.

NOTES

- ¹ The Constitution of the Republic of China (1946, amended 1994) at: www.gio.gov.tw/info/news/constitution.htm
- ² See “Organization of the Executive Yuan and its Functions” at: www.ey.gov.tw
- ³ Interviews in Taipei, 24 - 27 October 2005.
- ⁴ Constitution of ROC, Article 107.
- ⁵ The Organic Law of the Executive Yuan (1948, amended 1949).
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- ⁷ Interviews in Taipei, 16 October – 18 November 2003.
- ⁸ Interviews in Taipei, 8-12 November 2004.
- ⁹ “Guidelines for the Selection of Substitute Treasuries by Local Governments,” last revised in August 2003. www.mof.gov.tw/content.asp?CuItem=13646&baseDSD=5&CtUnit=120
- ¹⁰ Interviews in Taipei, 16 October – 18 November 2003.
- ¹¹ Interviews in Taipei, 8-12 November 2004.
- ¹² *The Directorate-General of Budget, Accounting and Statistics in Brief*, DGBAS, 2001.
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- ¹⁵ Interviews in Taipei, 8-12 November 2004.
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- ¹⁷ “Fiscal Watchdog Should Think Ahead”, *Taipei Times*, 26 June 2004, p. 8
- ¹⁸ Interviews in Taipei, 8-12 November 2004.
- ¹⁹ Interviews in Taipei, 24 - 27 October 2005.
- ²⁰ Interviews in Taipei, 16 October – 18 November 2003.
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- ²⁴ ‘Taiwan: Reforms come up against obstacles’, *Oxford Analytica Daily Brief*, 23 February 2005.
- ²⁵ Interviews in Taipei, 24-27 October 2005.
- ²⁶ Primasia News, Financial Supervisory Commission, 8 November 8 2004.
- ²⁷ Interviews in Taipei, 24-27 October 2005.
- ²⁸ Interviews in Taipei, 8-12 November 2004.
- ²⁹ The European Chamber of Commerce Taipei, “Banking: 2003,” www.ecct.com.tw/committees/banking/2003banking.php; Interviews in Taipei, 16 October – 18 November 2003.
- ³⁰ “Taiwan: Infrastructure plan faces political obstacles,” *Oxford Analytica Daily Brief*, 26 June 2003; Francis Lee, “Infrastructure projects seek private investors,” Government Information Office at: www.gio.gov.tw
- ³¹ ‘Taiwan: Reforms come up against obstacles’, *Oxford Analytica Daily Brief*, 23 February 2005.
- ³² www.tobacco.org/news/162776.html and interviews in Taipei, 24-27 October 2005.
- ³³ Interviews in Taipei, 24-27 October 2005.
- ³⁴ “Taiwan Cooperative Bank completes privatization”, *Taipei Times*, 5 April 2005.
- ³⁵ Interviews in Taipei, 24-27 October 2005.
- ³⁶ Interviews in Taipei, 8-12 November 2004.
- ³⁷ Interviews in Taipei, 8-12 November 2004.
- ³⁸ <http://www.mofnpb.gov.tw/~bnp/ec1.htm>.
- ³⁹ *The Directorate-General of Budget, Accounting and Statistics in Brief*, DGBAS, 2001, pp. 7-8, 21.
- ⁴⁰ *Guide to ROC Taxes 2001*, Taxation and Tariff Commission, MoF, pp. 1-2.
- ⁴¹ Interviews in Taipei, 24-27 October 2005.
- ⁴² Interviews in Taipei, 8-12 November 2004.
- ⁴³ Commentators noted that a recent media investigation found that only 40% of corporations are paying their income tax. Interviews in Taipei, 24-27 October 2005.
- ⁴⁴ ‘Taiwan: Tax reforms set for stormy ride’, *Oxford Analytica Daily Brief*, 16 June 2005.
- ⁴⁵ Employees in the military and education sectors also receive 18% interest on deposit savings, which creates a heavy burden on the government.
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- ⁴⁷ Interviews in Taipei, 24-27 October 2005.

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- ⁴⁸ Interviews in Taipei, 24-27 October 2005.
- ⁴⁹ Interviews in Taipei, 24-27 October 2005.
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- ⁵¹ Interviews in Taipei, 8-12 November 2004.
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- ⁵⁵ Interviews in Taipei, 8-12 November 2004.
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- ⁵⁹ Interviews in Taipei, 16 October – 18 November 2003.
- ⁶⁰ www.mof.gov.tw/engWeb/webPage.asp?CuItem=14317; “Financial Statistics, Advance Release Calendar,”
www.mof.gov.tw/public/Data/statistic/calendar/calendar1117.doc
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- ⁶² “Financial Statistics,” MoF website, at: www.mof.gov.tw/engWeb/default.asp
- ⁶³ Interviews in Taipei, 8-12 November 2004.
- ⁶⁴ Interviews in Taipei, 8-12 November 2004.
- ⁶⁵ Interviews in Taipei, 8-12 November 2004.
- ⁶⁶ Interviews in Taipei, 24-27 October 2005.
- ⁶⁷ www.stat.gov.tw/bs1/sdds/calendar.htm.
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- ⁶⁹ Interviews in Taipei, 24-27 October 2005.
- ⁷⁰ www.mof.gov.tw/public/Data/statistic/calendar/calendar1117.doc
- ⁷¹ www.dgbas.gov.tw
- ⁷² www.dgbas.gov.tw
- ⁷³ Interviews in Taipei, 16 October – 18 November 2003.
- ⁷⁴ Interviews in Taipei, 24-27 October 2005.
- ⁷⁵ Interviews in Taipei, 8-12 November 2004.
- ⁷⁶ The European Chamber of Commerce Taipei, “Banking: 2003,”
<http://www.ecct.com.tw/committees/banking/2003banking.php>.
- ⁷⁷ Interviews in Taipei, 24-27 October 2005.
- ⁷⁸ Interviews in Taipei, 24-27 October 2005.
- ⁷⁹ Interviews in Taipei, 24-27 October 2005.
- ⁸⁰ Interviews in Taipei, 16 October – 18 November 2003.
- ⁸¹ The First Financial Holding Company no longer presents a problem; it now has low NPL ratios. The Bank of Overseas Chinese and the Chung Shing Commercial Bank have now been privatised. Interviews in Taipei, 8-12 November 2004 and 24-27 October 2005.
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- ⁸³ Interviews in Taipei, 8-12 November 2004.
- ⁸⁴ Interviews in Taipei, 24-27 October 2005.
- ⁸⁵ “Outlook for the Economy and the Banking Sector,” BOMA Memorandum, MoF, 2002; *Asian Development Outlook 2002*, Asian Development Bank, p. 40; *Taiwan Statistical Data Book 2002*; Jyh-Bang Jou, “Taiwan’s Public Finance Deficit Problem In Retrospect” (Paper Presented at the 2002 Annual Meeting of the Association of Third World Studies), National Taiwan University. Commentators noted that the definition of the national debt does not adhere to international standards, and that if it did the national debt figures would be considerably higher than those stated currently, particularly in contingent liabilities, such as pensions and healthcare, were to be included. They further noted that non-profit government funds are in debt, and these are also not included in government debt figures. Interviews in Taipei, 24-27 October 2005.
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- ⁸⁷ Interviews in Taipei, 16 October – 18 November 2003.

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- ⁸⁸ Interviews in Taipei, 24-27 October 2005.
- ⁸⁹ Interviews in Taipei, 8-12 November 2004.
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- ⁹¹ Interviews in Taipei, 24-27 October 2005.
- ⁹² www.mof.gov.tw/content.asp?Cultem=13253&baseDSD=5&CtUnit=120
- ⁹³ *A Brief Introduction to DGBAS*, DGBAS, 1998, pp. 10-12
- ⁹⁴ Interviews in Taipei, 24-27 October 2005.
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- ¹⁰² www.audit.gov.tw/audeng/naolaw.htm
- ¹⁰³ www.audit.gov.tw/audeng/briefd.htm; Law of Audit, Articles 4-6, 47 www.audit.gov.tw/audeng/naolaw.htm
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- ¹⁰⁶ Constitution of ROC, Article 104.
- ¹⁰⁷ Constitution of ROC, Article 105.
- ¹⁰⁸ www.audit.gov.tw/audeng/Static.htm
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- ¹¹¹ www.dgbas.gov.tw/english/eng04.gif, <http://www.dgbas.gov.tw/english/eng04-1.gif>